3 November 2022

Sonal Badhan
Economist

Economic Round-up: October 2022

Major global economies are showing signs of stagflation. Latest PMI data for US, Eurozone shows that economic activity is beginning to weaken while retail prices continue to inch up. This is also taking a toll on consumption demand. China's strict Covid-19 lockdown measures are adding further adding to global growth woes. IMF has lowered global growth forecasts for CY23. Global central banks on the other hand continue to tighten their monetary policies in order to tame inflation, even as higher rates are beginning to show impact on the housing sector (US). We expect this trend to continue in the coming months and it will have to be seen at what inflection point (noting slowdown in growth and inflation) major central banks will begin to ease the pace of policy rate hikes.

Global growth: IMF now expects global growth to slow down further in CY23, dragged by Eurozone and emerging market economies. US economy is giving mixed signals. On one hand, while home sales, consumer confidence, consumer spending, PMIs are falling, on the other hand, headline GDP picked up pace in Q3, inflation remains elevated and labour market is tight. In Eurozone, energy crisis is keeping inflation high, which showing its impact on manufacturing and services activity. China too is struggling to keep the economic momentum going with retail sales, industrial profits down and stringent Covid lockdown measures impacting industrial production in Q4.

Global Central Banks: Recently major global Central Banks have announced their policy decisions. Both ECB and US Fed have announced another 75bps rate hikes as inflation levels continue to remain elevated in both regions. Both banks have made it clear that policy tightening will continue until inflation is significantly brought down, even as there persists considerable risks to growth. Other central banks such as RBA (25bps), central bank of Canada (50bps) too have increased rates, but have slowed down the pace. On the other hand, PBOC and BoJ still remain accommodative.

Key macro data releases: With data on the fiscal state of the government coming in for the first half of the year, the picture emerging is that the deficit is under control with 37.3% of the budgeted amount being used up so far relative to 35% last year. Capex growth has remained robust, while revenue spending is marginally lower. However, revenue spending is likely to pick up in the coming months as subsidies outlay has increased.

On the industrial production side, core sector output expanded to a 3-month high of 7.9% in Sep'22 from 4.1% in Aug'22. The improvement is led by coal and steel sector. Additionally, double digit growth in cement and electricity sector signal pick up in infrastructure activity. Strong demand on the back of festival surge provided further support. Fertilizers growth also largely remain steady as companies brace up for the sowing during Rabi season.

CPI for Sep'22 came in at 7.4%, up from 7% in Aug'22. With this, CPI has averaged 7% in Q2FY23, marginally lower than RBI's estimate of 7.1%. Food inflation continues to remain elevated and was up by 8.6% in Sep'22. Amongst them, vegetable inflation, cereals and products, pulses, and milk and milk products rose. Core CPI (excl. food and fuel) too edged up to 6.1% in Sep'22 from 5.8% in Aug'22 as well. Even RBI's preferred measure of core CPI (core excl. pan, tobacco and intoxicants) rose to 6.3% in Sep'22 compared with 6.1% in Aug'22. Barring amusement and recreation and personal care and effects, all other components of core inflation showed acceleration. Maximum traction was seen in housing and clothing & footwear inflation.

Global developments

Impending global recession

IMF has recently announced updated global growth forecasts (WEO) for both CY22 and CY23. While global GDP forecast for CY22 have been left unchanged from Jul'22 at 3.2%, forecast has been lowered for CY23 to 2.7% from 2.9% estimated earlier. Downward revision has been made in case of both, Advanced Economies (1.1% versus 1.4%) and Emerging Market and Developing Economies (3.7% versus 3.9%). Countries like Germany, Italy and Russia are estimated to witness contraction in CY23. Amongst the AEs, GDP estimate for US has been revised sharply lower for CY22 (1.6% versus 2.3% as per Jul'22 WEO) and has been left unchanged for CY23 (1%). In case of Eurozone, while CY22 estimates have been revised upward (3.1% versus 2.6%), they have lowered for CY23 (0.5% versus 1.2%). In case of India, growth estimate for the current fiscal year (FY23) has been reduced to 6.8% (7.4% earlier), but for FY24, it remains unchanged at 6.1%.

Macro data from the US is giving mixed signals with indicators such as home sales, PMIs, consumer confidence pointing towards slowdown, and CPI, unemployment rate, GDP, indicating economy continues to remain overheated. Most direct impact of increase in Fed Fund rates is visible on the US housing market. US new home sales have fallen by 10.9% (MoM) in Sep'22 as average 30-year mortgage rate is hovering ~20-year high. Further, higher inflation is also taking a toll on domestic consumption and consumer confidence index has fallen to 102.5 in Oct'22 from 107.8 in Sep'22. This was also visible in Q3CY22 GDP print. While headline GDP rose by 2.6% in Q3, ending the trend of negative growth of previous two quarters (-1.6% in Q1; -0.6% in Q2), it was largely due increase in net exports and build-up of inventories. On the other hand, consumption spending eased to 1.4% in Q3 from 2% in Q2. Inflation continues to bite as it remains elevated in Sep'22 at 8.2% versus est.: 8.1% and 8.3% in Aug'22. In addition, PMIs are now showing signs of marginal slowdown with ISM manufacturing easing to 50.2 in Oct'22 from 50.9 in Sep'22 and flash Markit services PMI dipping to 2 month low of 46.6 in Oct'22 from 49.3 in Sep'22. However, labour market continues to remain tight with unemployment rate for Sep'22 down to 3.5% from 3.7% in Aug'22. Thus Fed has increased its policy rate by another 75bps in its Nov'22 meeting.

Inflation in Eurozone continues to pinch on account of energy crisis and has risen to 10.7% in Oct'22 from 9.9% in Sep'22. The two major economies, Germany and France, also continue to witness higher prices with inflation up to 10.4% in Germany (10% in previous month) and 6.2% in France (5.6% last month). In Eurozone, the impact of inflation and weak global demand is weighing down both manufacturing and services activity. Manufacturing PMI has slipped to 29-month low of 46.4 in Oct'22 from 48.4 in Sep'22, while flash services PMI is down to 20-month low of 48.2 in Oct'22 from 48.8 in Sep'22. These high frequency indicators show that the impact of this on GDP will be visible from Q4 onwards. In Q3, Germany's GDP surprised positively and rose by 0.3% versus est.: (-) 0.2% decline and 0.1% in Q12. However in France, the slowdown continues as GDP growth eased to 0.2% from 0.5% in Q2. Germany's ZEW investor sentiment continues to remains pessimistic, although the level of pessimism has declined marginally with index at (-) 59.2 points in Oct'22 versus est.: (-) 65.7 and (-) 61.9 in Sep'22. With inflation elevated, it can be expected that ECB will continue hiking rates and begin winding down its balance sheet even as risks to recession have increased.

Another major risk to global growth comes from China, wherein government continues to impose strict Covid-19 lockdown measures in major cities, hurting both manufacturing production and domestic demand. China's GDP in Q3 rose by 3.9% from 0.4% in Q2, mainly supported by tier 2 and tier 3 cities. For instance, in CYTD22 (Jan-Sep), Beijing's GDP was up by only 0.8%, while Shanghai's GDP has fallen by (-) 1.4% compared with national

average of 3% growth. On the other hand, cities like Guangzhou and Shenzhen have recorded 2.3% and 3.3% growth respectively. Lockdown measures and dip in commodity prices are also impacting profits of China's industrial firms as they have seen a decline of (-) 2.3% during Jan-Sep'22 period, compared with (-) 2.1% decline during Jan-Aug'22. Even retail sales growth has moderated to 2.5% in Sep'22 following 5.4% increase in Aug'22. Although loose monetary policy and relaxation in restrictions on home buying is seem to be supporting FAI and industrial production. FAI was up by 5.9% during Jan-Sep'22 from 5.9% during Jan-Aug'22. Industrial output too had picked up pace in Sep'22 (6.3%) compared with last month (4.2%). However in Q2CY22, with resurgence in Covid-19 cases and lockdown imposed in industrial parks (Foxconn Park) and factories (carmaker Nio), industrial output will get dented.

RBI

RBI has announced an additionally meeting of MPC members on 3 November 2022 to discuss its response to the central government on inflation management. It is likely that RBI will cite supply side issues and Russia-Ukraine war as key reasons behind inflation breaching the targeted mark of 6% for three continuous quarters. International fuel and commodity prices had accelerated sharply following the onset of Russia-Ukraine war and lack of domestic capacity for production of edible oils also impacted food prices. Further, untimely/delayed monsoon have impacted Kharif production, in particular rice and wheat. RBI is also expected to respond on corrective measures taken timeline under which it expects inflation to fall back within the targeted range. Managing liquidity and hiking rates will be proposed to be continued in order to manage interest rates and inflation expectations.

Global central bank decisions

ECB increased its main benchmark lending rate by 75bps in its Oct'22 policy meeting, taking the rate to 1.75%—level not seen since 2009. Previously the central bank had hiked rate by 75bps in Sep'22 and 50bps in Jul'22. Further, terms and conditions of TLTRO (tool to incentivise lending to real economy as it can be used by banks to borrow from the central bank at attractive rates) have been tweaked. From 23 Nov 2022, the interest rate on TLTRO III will match the deposit facility rate—ECB's main benchmark lending rate.

Steep rise in rates is on account of continuously accelerating inflation (9.9% in Sep'22; 9.1% in Aug'22). This is also hurting growth prospects and it is now widely estimated that European economies will enter a recession in the last quarter of CY22 or first quarter of CY23. Major economies like Germany and France are already showing signs of slowdown. Despite this, ECB is expected to further hike rate in Dec'22 and will also discuss winding down of its EUR 8.8tn balance sheet as part of quantitative tightening.

Reserve Bank of Australia (RBA) increased the policy rate by another 25bps today, following 25bps increase in Oct'22 and 50bps increase in Sep and Aug'22 each. With this RBA has increased rates 7 times starting from May'22, taking the policy rate to 2.85%. Stubborn inflation and continued pressure on wages implies that RBA will hike rates further, despite signs of slowdown in economy. Inflation is expected to peak at 8% later in CY22 and is expected to come down 4.75% by CY23.

US Fed has delivered its 6th rate hike and another 75bps increase in Fed Fund rate, in order to slowdown overheating of the economy. Inflation remains elevated, although it is expected to come down in the coming months as commodity prices cool and growth slows down.

On the other hand, BoJ and PBOC have reaffirmed their stance to remain accommodative. In case of Japan, policy divergence is hurting Yen and central bank has reportedly intervened in the forex market to stem Yen's fall (currently hovering around 32-year low). Analysts expect BoJ to move towards change in stance only from next year, when increase in wage growth begins to impact inflation. Until then, the current stance and Yen's decline is expected to continue.

PBOC has kept lending rates unchanged in Oct'22 (1Y LPR at 3.65%; >5Y LPR at 4.3%). Slowdown in economic growth implies that PBOC will continue maintain loose monetary policy to support growth. In addition, despite Yuan currently trading near 15-year low, PBOC is not expected to intervene as depreciation yet to impact domestic inflation in a significant manner.

Special studies

Bank Deposits or Mutual Funds?

It has been a matter of debate whether Bank deposits are still the preferred choice of instrument of financial savings. With a changing financial landscape, volatility in the interest rate regime and risk taking appetite increasing, there has tended to be a change in the pattern of deployment of financial savings. RBI's recent report on financial assets of households show that there has been a shift in pattern, where mutual funds and equity witnessed sharp increase in FY22 with shares of 6.3% and 1.9% in overall financial assets respectively (ratio was 2.6% and 1.1% in FY20), while share of bank deposits declined to 25.5% in FY22 from 34.4% in FY20. However it must be pointed out that the quantum of bank deposits is much larger, about 4.1 times than that of mutual funds denoted by AUM (assets under management).

Key conclusions:

- Since FY16 (till Sep-22), total bank deposits have shown an accretion of Rs 77 lakh crore. Within that, term deposits have increased by Rs 66 lakh crore. A secure interest rate regime and risk averse sentiment have worked in favour of garnering bank deposits at a faster pace.
- On the other hand, net AUM of Mutual funds rose by Rs 26.1 lakh crore, in the same period, which is just about 1/3rd of the pace of accretion in bank deposits. Most of the mobilization was in equity funds, which increased by Rs 10.8 lakh crore. Debt funds rose at a much slower pace of Rs 4.8 lakh crore. The balance was from 'others' component which comprises hybrid schemes among others.
- The 'substitution analysis' shows that the larger part of substitution that has taken place between bank deposits and Mutual Funds has been mainly with equity funds.
- Bank deposits have grown at double digit rate in 3 out of 6 years. In these years (except Mar-21), interest rates on term deposits (Weighted Average Domestic Term Deposit Rate-WADTR) remained favourable in the range of 6.89-6.97%.
- Equity Mutual Funds have also shown steady growth and the movements corroborate with those in Sensex. For example in FY20 when Sensex fell sharply by 23.8%, AUM-MF (Equity) also declined by 32.4%. In FY21, as Sensex rose by 68%, AUM-MF (Equity) also picked up by 66%. In FY23 however, while the Sensex has moved up marginally equity funds have witnessed high growth of 13.8% as risk appetite has increased in a

regime of low interest rates. Interestingly, the WADTDR has increased during this period though low at 5.29%.

- In case of debt Mutual Funds, growth was in double digits for only 2 years where even bank deposits grew at a similar rate. In FY21 as consumption was restricted, savings increased in all the three avenues i.e. deposits, debt funds and equity funds.

It can be said that bank deposits would face competition from mutual funds as households get more market savvy and are willing to take their chances in the capital market. Mutual funds provide a safer way by pooling resources and investing the same based on professional judgment. Within various mutual funds schemes, debt funds have still not caught on relative to equity and hybrid ones. A rather under developed secondary market and a more complex market to understand could be the reasons behind this phenomenon.

Cash imbalances of states

In the current fiscal year, we have noticed that there are a number of states which have been consistently using RBI's cash flow management facilities in order to meet their fiscal commitments. While these facilities are provided with an objective of meeting temporary mismatches, some states are using them on a regular basis which signals possible liquidity stress.

RBI has made provisions for 3 kinds of facilities namely, Special Drawing Facility (SDF), WMA (Ways and Means Advances) and OD (Over Draft), for "State Governments to tide over temporary mismatches in the cash flows of their receipts and payments". Looking at the current trends (Apr'22-Aug'22) in utilization of SDF/WMA/OD facilities by states, some of the major states which seem to be having problems in fiscal management include:

- Andhra Pradesh, Telangana, Punjab and Rajasthan.
- Majority of the North Eastern states have also been using RBI's cash flow management facility consistently.
- Maharashtra, Assam and Karnataka have taken recourse to SDF while Kerala has used WMA too. However, the number of days for which they have availed this facility is low unlike the top four.

On an average, Andhra Pradesh and Telangana have availed Rs 712 and Rs 735 crore respectively under SDF facility alone this fiscal year. Out of the 153 days (Apr-Aug), these states availed SDF for 133 and 152 days respectively. Amount accessed via WMA was even higher, averaging Rs 1,773 crore for Andhra Pradesh and Rs 1,206 crore for Telangana, and that too on a regular basis. Even OD facility was availed, which is provided at rates higher than repo rate. Amongst the North-Eastern states, Manipur, Mizoram and Nagaland are the ones which have availed all three facilities. Other worrisome trend emerges from Rajasthan and Punjab, which too availed funds under SDF facility for 110 and 90 respectively, out of a total of 153 days. Average funds availed by them were higher than those accessed by Andhra Pradesh and Telangana.

On the other hand, there are states which have never or rarely resorted to these cash management facilities. States like Gujarat, Tamil Nadu, and Bihar have never (since 2017) accessed these facilities and even states like Odisha, UP, and Madhya Pradesh, have availed them very rarely.

RBI in its study identified 10 "vulnerable states" in terms fiscal management and these included: Andhra Pradesh, Bihar, Haryana, Jharkhand, Kerala, Madhya, Punjab, Rajasthan, Uttar Pradesh and West Bengal. The report noted that in terms of debt-GSDP ratio, "highly stressed states are Bihar, Kerala, Punjab, Rajasthan, and West

Bengal". It further added that "states (such as) Andhra Pradesh, Bihar, Rajasthan and Punjab exceeded both debt and fiscal deficit targets for FY21 set by the 15th Finance Commission."

Monthly fiscal accounts of states show that Andhra Pradesh, Telangana, Punjab and Rajasthan have much lower revenue receipts in comparison to total expenditure made by them during the current fiscal year. This implies higher reliance on market borrowings/grants in aid from centre to make ends meet. This could also be why they are more consistently accessing RBI's cash management facilities. Amongst the North Eastern states, this trend visible in the accounts of Mizoram and Nagaland.

In comparison, state like Gujarat has balanced well between expenditure and revenue receipts. In case of Bihar and Tamil Nadu too, there seems to be greater reliance on market borrowings and grants in aid from centre, but it is managed in such a way that RBI's cash management facilities have never been accessed. In case of Odisha and UP too, there is balance between spending and revenue receipts.

RBI's study also noted that amongst the 10 vulnerable states, "share of revenue expenditure in total expenditure of these states varies in the range of 80-90%. Some states like Rajasthan, West Bengal, Punjab and Kerala spend around 90% in revenue account. This results in low expenditure quality, as reflected in their high revenue spending to capital outlay ratios.

It must be noted here that while there is nothing wrong in accessing these facilities occasionally, to manage "temporary mismatches", using them on a regular basis is symptomatic of challenges in managing expenditure. Going forward as repo rate continues to increase, cost of accessing these facilities, mainly WMA and OD will continue to inch up, and will narrow the margin with SDL yields.

Will credit growth slow down due to repo rate hikes?

After keeping repo rate unchanged at a record low of 4% for 2 years, RBI announced a 40 bps hike in repo rate in May'22. This was in response to rising inflation and the evolving global economic situation typified by uncertainties that go with war. Since then, RBI has raised repo rate by a cumulative 190 bps. In response, banks have also announced increases in their respective lending as well as deposit rates.

Compared with a 140 bps increase in repo rate (before the last rate hike of 50 bps on September 30), deposit rates on term deposits of banks (more than 1 year maturity) has increased by only 40bps. Even in terms of weighted average domestic term deposit rate (WADTDR), the rate hikes are muted at 26bps for SCBs (as of Aug'22). However, within this group, foreign banks have been much more responsive with an 87bps increase in WADTDR.

In terms of lending rates, the transmission is much better. Both in terms of MCLR (+50bps) and WALR (+41bps), interest rates have increased more than the increase in deposits rate (1 year average as well as WADTDR). Here again, foreign banks have been more proactive in passing on the rate hikes to the customers.

Despite rising rates, credit demand has grown at a robust rate in FYTD23. In fact, credit growth has risen by 4.2% since Apr'22 (since RBI hiked repo rate) compared with 1.3% in the same period last year led by an increase in non-food credit. Credit growth to all major sectors has shown a pickup. While a part of the increase in credit can be attributed to a positive base effect, a pickup in economic activity has also ensured a steady demand for credit.

The coefficient of correlation between growth in credit on an annual basis and repo rate at the end of the period, form 2000-01 to 2021-22 is 0.30, while on an incremental basis is 0.19. Both ways the correlation coefficient is positive and not negative, which it would have been in case credit growth slows down. The clue is in the state of

the economy. With the economy growing at a steady pace, higher rates were not a limitation to credit growth even when the repo rate was high/increasing. Similarly, with interest rates kept low during the Covid-19 time, a boost was not seen in credit.

Investment may start picking up

There could be some good news based on the new investment announcements made by companies in the first half of the year. CMIE data showed that these announcements, which can be read as being investment intentions, have shown a pick-up which augurs well for the investment cycle. These intentions are for the non-government companies but include PSUs.

In the last 5 years, investment trend represented a U-shaped curve where investment announcements declined in 2019 and 2020 and then have picked up in the subsequent years. The amount involved of Rs 7.65 lakh crore is lower than that in 2018, though higher than 2021 by 19.3%. The crux will be having these intentions materialize. Although, new project announcements and overall gross fixed capital formation at the economy level show that, there is low correlation between the two, new investment announcements made is indicative of industry confidence levels in the economy which provides comfort in the present context. Further, as the PLI scheme is running there can be hope of a higher rate of fructification of such plans in specific sectors.

Which sectors have shown such intentions?

- In 2022, chemicals and related products and power accounted for 78% of total announcements made.
- The power sector has witnessed steady announcements over time with the share being high. On an average 23% has been accounted for by this sector.
- The transport sector (which is dominated by airlines and shipping) has witnessed high announcements in the past.
- Construction and real estate too have witnessed high shares in 2018 and 2019 which has however slowed down considerably in the last 3 years. This will be a reflection of new projects being launched by this sector.

Key policy developments

- The union cabinet, has approved the proposal of Ministry of Petroleum & Natural Gas to give one time grant amounting to Rs 22,000 crore to three Public Sector Undertaking Oil Marketing Companies (PSU OMCs). The grant will be distributed among IOCL, BPCL and HPCL. This move will help the PSU OMCs to ensure unhindered domestic LPG supplies. Domestic LPG Cylinders are supplied at regulated prices to consumers by PSU OMCs namely, IOCL, BPCL, HPCL. During the period from June 2020 to June 2022, the international prices of LPG increased by around 300%. However, to insulate consumers from fluctuations in international LPG prices, the cost increase was not fully passed on to consumers of domestic LPG. Accordingly, domestic LPG prices have raised by only 72% during this period. This had led to significant losses for these OMCs.
- Third advance estimates of area and production of horticultural crops for the year 2021-22 has been released. According to this, a record 342.33mn tonnes (334.6mn tonnes in 2020-21) are estimated to be produced in an area of 28.08mn hectares (27.48mn hectares in 2020-21). Production of fruits is

estimated to be 107.24mn tonnes (102.48mn tonnes in 2020-21). Production of vegetables is estimated to be 204.84mn tonnes (200.45mn tonnes in 2020-21). Production of Onion is estimated to be 31.27mn tonnes (26.64mn tonnes in the year 2020-21). Production of Potatoes is estimated to be 53.39mn tonnes (56.17mn tonnes in 2020-21). Tomato production is estimated to be 20.33mn tonnes (21.18 million tonnes in 2020-21).

Data Releases

Currency outlook: Focus on Fed

INR depreciated by 0.5% in the last fortnight even as DXY retreated from a 20-year high. While expectations of a likely slowdown in pace of Fed rate hikes drove DXY lower, slowdown in pace of FPI flows and dwindling macro fundamentals drove INR lower. Fed decision and commentary will determine the trajectory of the dollar, which in turn will determine the movement in INR. In the absence of any shocks, we expect INR to trade in the range of 82.5-82.95/$ in the near-term.

Bond Market Round-up

Global bond market was in a trap trying to untangle growth-inflation dynamics. High frequency indicators in the US and Eurozone reflected slowdown in growth; while inflation worries were aggravated. In the Eurozone inflation again reached a new high. Among the most notable yield movement has been the complete reversal of direction in UK's 10Y yield which fell by 58bps in Oct'22 against 129bps increase seen in Sep'22. This was supported by growing sentiments over fiscal credibility under the newly elected PM. US Fed in its upcoming policy is expected to go for a 75bps hike, yet some slowdown with regard to future pace of rate hike is expected, as impact of frontloading on macro data points are already visible. On the domestic front, India's 10Y yield traded in the range of 7.36-7.51% in Oct'22, though it exhibited less volatility in trading compared to Sep'22. Some degree of buying was supported by risk off sentiment on account of contagion impact of global growth slowdown. Further, MPC members statement hinting that quite a bit of frontloading has already happened, did not allow yields to increase much. Notable development in the current month has been the correction in short end yield. Cut off for the short tenor papers rose at much slower pace in Oct'22 compared to Sep'22. Liquidity remained in deficit for 14 days in Oct'22. Going forward we expect, either neutrality or deficit in liquidity to be the new normal, considering that credit is at a double digit pace and RBI's forex intervention will continue. We expect India's 10Y yield to trade in the range of 7.35-7.50% in the next 30 days.

Core industries

Core sector output expanded to a 3-month high of 7.9% in Sep'22 from 4.1% in Aug'22. The improvement is led by coal (12% from 7.7% in Aug'22) and steel sector (6.7% from 5.2% in Aug'22). Additionally, double digit growth in cement (12.1% from 1.8% in Aug'22) and electricity sector (10.9% from 1.4% in Aug'22) signal pick up in infrastructure activity. Strong demand on the back of festival surge provided further support. Fertilizers growth also largely remain steady as companies brace up for the sowing during rabi season. However, sector such as petroleum refinery, crude oil and natural gas disappointed. On a FYTD basis, output of eight core sector rose by

9.6% in Apr-Sep'22 compared with a growth of 16.9% in Apr-Sep'21. We expect industrial growth to be between 4-5% in Sep'22.

Central government finances

With data on the fiscal state of the government coming in for the first half of the year, the picture emerging is that the deficit is under control with 37.3% of the budgeted amount being used up so far relative to 35% last year. The positive takeaway is that capex is 45.7% of target which is higher than 41.4% last year. Here, there has been a sharp rise for railways while roads has been maintained. Revenue expenditure is marginally lower this year so far. We may expect some acceleration here with the free food scheme being extended by the government till the end of the calendar year. However in case of fertilizer subsidy on urea there has been a jump to 87% of target (54%). This is a potential point for slippage. On the revenue side the increase in gross tax collections is 17.6%, with corporation rising by 21.7% and income by 25.9%. Both customs and excise have come down by about 8% and 19% which has lowered pace of growth of overall collections. This trend will continue as the government is unlikely to raise excise on fuel; and with global commodity prices coming down, value of taxable imports will reduce. Based on revenue trends and growth prospects as well as higher expenditures that are targeted on subsidy, there can be a slippage of 0.2-0.3% in fiscal deficit ratio though the higher denominator due to nominal GDP being higher than expected will cushion the shock.

Update on corporate performance

Key takeaways from financial results of an aggregate of 386 companies include: **1)** Quarterly financial performance shows that net sales continue to grow at a robust double digit pace of 22.9% in Q2FY23 against 22.3% in Q2FY22; **2)** In absolute terms as well net sales saw an uptick of Rs 7.72 lakh crore in Q2FY23 against Rs 6.29 lakh crore in Q1FY22 and far above pre pandemic level of Rs 5.14 lakh crore; **3)** However, there seems to be divergence on the profitability frontier. Higher input cost have impinged on the PAT numbers which showed moderation in growth to 8.5% in Q2FY23 from 21.1% in Q1FY22 and pre pandemic's growth of 27.9% (supported by softer input prices at that time); **4)** Sector wise, banks seemed to have performed better. Banks' showed a double digit growth of PAT by 41.6% in Q2FY23 against 35.3% in Q2FY22, supported by higher interest income in the rising rate cycle; **5)** Net sales of FMCG companies remained buoyant growing by 19.3% in Q2FY23 compared to 12.1% in Q2FY22; **6)** For Auto companies, while net sales has shown some moderation, it still maintained a double digit growth rate of 20.3% compared to 32.8% in Q2FY22; **7)** However, festive cheer could not lift the consumer durables segment in which net sales only increased by 0.7% in Q2FY23 compared to 35% in the same period of previous year.

Increase in MSP for Rabi crops

Union government has announced MSPs for Rabi crops which are in the process of being sown and will be harvested post March 2023. The increase in MSP has been between 2-9% with the highest being offered for masoor and the lowest for gram. The increase for wheat is 5.5%. The MSPs have been raised keeping in mind the need to provide farmers fair remuneration. This year however, the government would have interest in ensuring that wheat procurement is on target as stocks have come down as of September due to deployment in the PM-food scheme for the poor.

The inflation concern is however still there as higher prices offered for wheat could lead to market prices rise by a higher rate. Wheat/atta inflation for September was at 17.4% while masoor was at 6.6%. In case of gram it was less than 1%- hence a low increase in MSP. The 7.9% increase in MSP for mustard is to enable farmers to increase their production which will help to lower import dependency of edible oils.

CPI inched up in Sep'22

CPI for Sep'22 came in at 7.4%, slightly higher than our estimate of 7.3%, and up from 7% in Aug'22. With this, CPI has averaged 7% in Q2FY23, marginally lower than RBI's estimate of 7.1%. Food inflation continues to remain elevated and was up by 8.6% in Sep'22 versus 7.6% in Aug'22. Out of 12 food and beverage items of inflation, 9 have shown a pickup in prices. Amongst them, vegetable inflation, cereals and products, pulses, and milk and milk products rose. Prices of eggs fell less sharply in Sep'22, than in the previous month. Commodities where inflation was seen moderating included: oils & fats, fruits, and non-alcoholic beverages. Going forward, impact of unseasonal rains in Oct'22 on sowing and harvest, and trajectory of oil prices will have to be closely watched. RBI expects inflation to average at 6.4%, however we believe significant upside risks to this persist.

Core CPI (excl. food and fuel) edged up to 6.1% in Sep'22 from 5.8% in Aug'22 as well. Even RBI's preferred measure of core CPI (core excl. pan, tobacco and intoxicants) rose to 6.3% in Sep'22 compared with 6.1% in Aug'22. Barring amusement and recreation and personal care and effects, all other components of core inflation showed acceleration. Maximum traction was seen in housing (7.7% in Sep'22 from 7.5% in Aug'22) and clothing and footwear (10.2% versus 9.9% in Aug'22) inflation. Lower gold prices contributed to a decline in inflation in the personal care and items to 6.8% compared with 7% in Aug'22. Pickup in demand due to improved economic activity and festive season has contributed to higher inflation in Sep'22.

WPI begins to cool

Headline WPI moderated for the 4th consecutive month in Sep'22 and was down to 10.7% (BoB est.: 11.8%) from 12.4% in Aug'22. Food inflation in Sep'22 inched down to 8.1% from 9.9% fin Aug'22. Barring prices of vegetables and milk, all other sub-components (food grains, fruits, protein based items, condiments & species) reflected cooling down of inflation in Sep'22. Prices of fruits, spices and eggs fell the most. Dip in food grain inflation was mainly owing to sharp decline in prices of pulses. However, cereal inflation still remains elevated at 11.9% in Sep'22 versus 11.8% in Aug'22. Within cereals, paddy inflation accelerated, while prices of wheat cooled down marginally. On a global level, World Bank's pink sheet shows that international rice prices rose for the second consecutive month in Sep'22. International prices of wheat too have risen. Vegetable inflation also remains a cause of concern as prices inched up. Unseasonal rains and rising international food prices pose upside risks to domestic prices in the coming months).

Fuel and power inflation in Sep'22 eased marginally to 32.6% from 33.7% in Aug'22, owing to dip in electricity index (20.5% in Sep'22 versus 25.7% in Aug'22). Coal prices remained unchanged at 2.5% for the second consecutive month in Sep'22. Mineral oil index inched up a tad to 46% from 45.4% in Aug'22, despite dip in international oil prices (21% in Sep'22 versus 38% in Aug'22). Within this, prices of petroleum coke, LPG and furnace oil fell the most. On a MoM basis, overall index indicates that fuel and power inflation is beginning to gather momentum (0.1% versus -5.4%), led by inching up of electricity (5.2% versus -0.1%) and mineral oil index (-1.3% versus -7.9%).

Core inflation eased for the fifth consecutive month in Sep’22 to 7% from 7.9% in Aug’22. Manufactured products inflation was also down at 6.3% in Sep’22 from 7.5% in Aug’22. Of the 22 commodity sub-indices, 14 indices rose at a slower pace in Sep’22 than Aug'22 led by basic metals, food products, textiles, paper, chemicals and rubber products. Within basic metals, prices of copper contracted for the third consecutive month in Sep’22, while that of aluminium fell for the third consecutive month in Sep’22. Prices of lead bars and zinc too contracted. Even on international level, as reflected in World Bank’s pink sheet, prices of aluminum, copper and lead have come down further in Sep’22. Global zinc prices too have moderated.

IIP growth eased

As against our expectations (3.5%), industrial output contracted for the first time in over 18 months to 0.8% in Aug’22 from 2.2% in Jul’22. This was led by broad based slowdown, with both manufacturing and mining output declining by 0.7% (+3.0% in Jul’22) and 3.9% (-3.3% in Jul’22) respectively in Aug’22. Electricity output decelerated (7-month low) further to 1.4% in Aug’22 compared with 2.3% in Aug’22. Within manufacturing, output contracted the most in case of wearing apparel, pharma and electrical equipment. Output of printing, chemicals and basic metals also moderated in Aug’22 from the previous month. However, compared with the levels seen in 2019 (pre-pandemic period), IIP growth was up by 4% in Aug’22 versus 2% in Jul’22.

Within use-based too, broad based moderation was noticed across all sectors. Output of consumer non-durables contracted sharply to more than 2-year low in Aug’22 (9.9%) compared with contraction of 2.8% in Jul’22. Consumer durable output also declined. Furthermore, sharp moderation was registered under intermediate and infra goods. Production of primary goods and intermediate goods also registered slower growth.

Second half of FY23 is expected to provide significant support to growth on the back of favourable base. Production is also likely to be buoyant on the back of the festive demand. International agencies such as IMF have warned of global recession in some countries this year, though it noted that compared to other countries ‘India has been doing fairly well and is expected to grow robustly next year’. However, tight global monetary conditions, price pressures, and Ukraine-Russia conflict might derail the recovery.

Disclaimer

The views expressed in this research note are personal views of the author(s) and do not necessarily reflect the views of Bank of Baroda. Nothing contained in this publication shall constitute or be deemed to constitute an offer to sell/ purchase or as an invitation or solicitation to do so for any securities of any entity. Bank of Baroda and/ or its Affiliates and its subsidiaries make no representation as to the accuracy; completeness or reliability of any information contained herein or otherwise provided and hereby disclaim any liability with regard to the same. Bank of Baroda Group or its officers, employees, personnel, directors may be associated in a commercial or personal capacity or may have a commercial interest including as proprietary traders in or with the securities and/ or companies or issues or matters as contained in this publication and such commercial capacity or interest whether or not differing with or conflicting with this publication, shall not make or render Bank of Baroda Group liable in any manner whatsoever & Bank of Baroda Group or any of its officers, employees, personnel, directors shall not be liable for any loss, damage, liability whatsoever for any direct or indirect loss arising from the use or access of any information that may be displayed in this publication from time to time.

Visit us at www.bankofbaroda.com

For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
+91 22 6698 5143
chief.economist@bankofbaroda.com
sonal.badhan@bankofbaroda.com